No. 85-568 (19)

IN THE

Supreme Court of the United States

October Term, 1985

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Appellants,

v.

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Appellees.

On Appeal from the Supreme Court of North Carolina

BRIEF FOR THE TOWN OF HIGHLANDS, NORTH CAROLINA, AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

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QUESTIONS PRESENTED

1. Is a state preempted from setting a utility's rates to retail customers by "rolling-in" all costs of two integrated utilities (including those costs incurred under FERC-filed rate schedules) and allocating those combined costs to the public on the basis of load, so as to require a utility and its sole stockholder, rather than the utility's ratepayers, to bear the costs of the stockholder's abuse and manipulation of its subsidiary for the stockholder's benefit, where FERC explicitly recognized that the state's determination regarding roll-in may differ from its own, and where FERC itself did not follow the FERC-filed rate schedules in setting that utility's rates to wholesale customers?

2. Is a state precluded by the Commerce Clause from setting retail rates in the above-described manner and placing refund responsibility on the utility and its stockholder, where the sole stockholder is an industrial corporation with a plant located in another state and chooses to attribute the refunds imposed on it to its costs of production in that other state?

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BRIEF FOR THE TOWN OF HIGHLANDS, NORTH CAROLINA, AS *AMICUS CURIAE* IN SUPPORT OF APPELLEES

The Town of Highlands, North Carolina, purchases power from Nantahala Power and Light Company ("Nantahala") at wholesale. Highlands was an active participant in the roll-in proceedings at the Federal Energy Regulatory Commission ("FERC") which paralleled the North Carolina Utility Commission ("NCUC") proceedings here appealed.[1] Aluminum Company of America ("Alcoa") and some of its allies, most

[1] *Nantahala Power and Light Co.*, Opinion No. 139, 19 F.E.R.C. ¶ 61,152, *reh'g. denied*, Opinion No. 139-A, 20 F.E.R.C. ¶ 61,430, Opinion No. 139-B, 21 F.E.R.C ¶ 61,222 (1982), *aff'd*, *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984). Highlands also is a key participant in the ongoing litigation before the FERC concerning Appellants' subsequent efforts to contractually separate Nantahala and Tapoco, Inc. *Tapoco, Inc.*, 30 F.E.R.C. ¶ 63,050, *clarified*, 31 F.E.R.C. ¶ 63,056 (1985) (exceptions pending).

egregiously the Federal Amici,[2] seriously mischaracterize the FERC decisions which are so critical to the issues raised before this Court. Highlands, as a political subdivision of the State of North Carolina, files this brief pursuant to Supreme Court Rule 36.4.

INTRODUCTION AND COUNTERSTATEMENT OF THE CASE

Alcoa and its supporters labor hard to present this case as something it is not. This is not a case of conflict between retail electric regulation in Tennessee and North Carolina, or a case in which North Carolina sought to benefit its electric consumers at the expense of Tennessee consumers. It *is* a case in which the NCUC has protected the retail public load of what it found to be an integrated Nantahala/Tapoco electric system from exploitation by the system's sole shareholder, Alcoa, which had transferred low-cost power to its aluminum plant in Tennessee.

Nor do the North Carolina decisions conflict with any order of the FERC. FERC Opinion No. 139 did *not* allocate costs between affiliated utilities or between states. The FERC addressed the New Fontana Agreement ("NFA") and the 1971 Apportionment Agreement only in the context of setting Nantahala's rates to three *wholesale* customers. The FERC's exercise of discretion to reject rolled-in ratemaking for Nantahala's wholesale rates does not preempt the NCUC from using roll-in for Nantahala's *retail* rates. The FERC's finding of no abuse of the Federal Power Act does not preempt the NCUC from determining that the affiliated North Carolina public utilities — including Alcoa itself — have abused North Carolina law. The FERC cannot preempt the NCUC now through mischaracterizations of Opinion No. 139 in a brief; nor can Alcoa do so by choosing to attribute its refund liability to the cost of electricity at its Tennessee plant.

[2] The Solicitor General of the United States and the Federal Energy Regulatory Commission. Tennessee, Edison Electric Institute ("EEI"), and New England Electric System ("NEES") also filed briefs supporting Alcoa.

Conspicuously absent from the briefs of Alcoa and its allies is the long history of Alcoa's manipulations to obtain low-cost hydroelectric power at the expense of the public, discussed by the North Carolina Supreme Court (Jurisdictional Statement Appendix ("App.") 18a-32a). The Nantahala and Tapoco hydroelectric systems are the end result of more than 40 years of corporate organizations, acquisitions and name changes, and transfers of hydroelectric properties among Alcoa, its various subsidiaries and the Tennessee Valley Authority ("TVA"), maneuverings that appropriated the least-cost generation for Alcoa's smelter (*id.* at 18a-20a, 23a-24a, 25a-26a). Alcoa sought preferred access to even Nantahala's hydroelectric power by purchasing most of Nantahala's output at rates lower than Nantahala's costs *and* lower than its rates to other retail customers. The North Carolina courts previously ruled that this was unlawful discrimination. *Utilities Comm'n* v. *Mead Corp.*, 238 N.C. 451, 78 S.E.2d 290 (1953), discussed at App. 26a-28a. At the time it negotiated the NFA, Alcoa sought to obtain all of Nantahala's major hydroelectric generation for its own use by selling the distribution system. The North Carolina Supreme Court halted the sale. *Utilities Comm'n* v. *Haywood Electric Corp.*, 260 N.C. 59, 131 S.E.2d 865 (1963), discussed at App. 28a-29a. In the 1960's, Nantahala's public load grew substantially, but Alcoa added no generation to the Nantahala system (*see* App. 26a-27a). In 1971, Alcoa ceased purchasing directly from Nantahala, but indirectly appropriated part of Nantahala's generation, through Tapoco, in the 1971 Apportionment Agreement (*id.* at 30a-31a). Nantahala was left to obtain the growing amounts of supplemental power it needed to serve its public load from TVA, whose rates escalated dramatically during the 1970's (*id.* at 31a-32a).[3] Throughout this history, Alcoa engaged in a largely successful effort to evade Federal regulation of its subsidiaries' hydroelectric projects and of the bulk power contracts with TVA, and with and among its subsidiaries, which maximized the usefulness of the Nantahala/Tapoco

[3] Compare Alcoa Br. 6.

system resources for aluminum smelting (*id.* at 19a-20a, 21a-22a, 29a, 30a, 31a).[4]

In the orders at issue here, the NCUC looked through the structure created by Alcoa and found a single integrated Nantahala/Tapoco system, and domination of Nantahala for the shareholder's benefit and to the injury of Nantahala's ratepayers. To remedy this abuse, the NCUC combined the two systems for ratemaking purposes, and allocated costs to the public using the methodology commonly used for utilities that operate in more than one state. The NCUC pierced the corporate veil between Nantahala and Alcoa to hold the parent responsible for its injury to the public. *See infra* at page 24.

In the parallel wholesale rate case,[5] the FERC held that Nantahala's arrangements with its affiliates did not compel

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[4] Alcoa (Br. 6 n.9) asserts that its refusal to file the 1971 Apportionment Agreement as a FERC rate schedule until 1980 was merely based on a "technical dispute." To the contrary, Tapoco's October 9, 1980 letter to the FERC filed the contract "under protest", asserting (at 1-2): "This agreement does not provide for any sales for resale or for the transmission of electricity in interstate commerce." The Commission's 1981 order accepting the contract for filing effective in 1971 reflects that the services commenced in 1971 (App. 265a), not the alleged earlier availability of the contract in the files as Alcoa claims. Opinion No. 139 held that the 1971 contract and an earlier (1963) apportionment contract (which, like the Original Fontana Agreement, was never filed) should have been filed as rate schedules when entered into (App. 299a).

[5] Although Alcoa now argues that the NCUC proceedings were *ultra vires* insofar as they addressed the NFA and 1971 Apportionment Agreement (Br. 9-10), Alcoa's July 10, 1978 "Answer and Request for Dismissal . . ." of Highlands' roll-in complaint in FERC Docket No. EL78-18 argued that the *FERC* investigation requested by Highlands "would be repetitive of the recent investigation by the North Carolina Utilities Commission. . ." (at 43). Alcoa further attempted to prevent FERC review by stating (at 5):

> Sales to the wholesale customer class, of which Highlands is a member, represent a very small portion of Nantahala's sales of electricity. . . . The North Carolina Utilities Commission, which is the state regulatory body charged with protecting the interest of Nantahala's retail customers, has determined that the contractual arrangements through which Nantahala supplies its wholesale and retail electrical load are just and reasonable. This Commission should respect the decision of the NCUC as that of a responsible regulatory body and should defer to that decision under principles of comity between state and federal regulation.

Alcoa now characterizes the NCUC's 1977 order as deferring to "FERC-regulated rate schedules" (Br. 9), even though the 1971 Apportionment Agreement was not filed with FERC until three years later.

roll-in to set rates to Nantahala's wholesale customers. Opinion No. 139, App. 290a-295a; Opinion No. 139-A, App. 304a-308a. The FERC explicitly acknowledged the NCUC's earlier use of roll-in to set Nantahala's retail rates as based on "criteria which each ratemaking authority may deem relevant." Opinion No. 139-A, App. 305a. The Fourth Circuit affirmed the FERC's roll-in determination as an exercise of ratemaking discretion. *Nantahala Power and Light Co.* v. *FERC*, 727 F.2d 1342, 1348 (4th Cir. 1984). In the context of determining whether wholesale roll-in was appropriate under the applicable FERC standard, the FERC considered Nantahala's past and then current contracts with affiliates to "examine any intercorporate transactions . . . which might distort customer cost responsibility." Opinion No. 139, App. 293a. *See also id.* at 291a-292a. The FERC did *not* approve or modify the NFA or the 1971 Apportionment Agreement to determine a just and reasonable allocation of costs between North Carolina and Tennessee or between Tapoco and Nantahala.[6] The FERC stated explicitly that the decision did not affect Tapoco's entitlements under those rate schedules. Opinion No. 139-A, App. 309a. Rather, in determining the rates for Nantahala's wholesale customers, the FERC found that Nantahala inexplicably had surrendered the greater benefits of an earlier (unfiled) Nantahala-Alcoa

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[6] Nowhere in Opinion No. 139 or 139-A did FERC make a finding that the 1971 Apportionment Agreement (with the exception of the unfair energy entitlements) was "just and reasonable", notwithstanding Alcoa's assertions to the contrary. *See, e.g.*, Alcoa's purported description (without citation) of Opinion Nos. 139 and 139-A (Br. 24). Also deceptive is Alcoa's attempt to strain the Administrative Law Judge's ultimate conclusion with regard to the justness and reasonableness of the Nantahala *wholesale* rates he recommended (Alcoa Br. 8-9).

apportionment contract without consideration, and that the 1971 Apportionment Agreement was unfair to Nantahala. It therefore set rates as if Nantahala had received more TVA energy than it was entitled to receive under the 1971 Agreement. Opinion No. 139, App. 295a-298a; Opinion No. 139-A, App. 309a, 311a. The FERC characterized its evaluation of "the prudence of the costs incurred by Nantahala" as an exercise of its authority to set just and reasonable wholesale rates. Opinion No. 139-A, App. 312a.

SUMMARY OF ARGUMENT

With regard to the Supremacy Clause, Alcoa and its allies are asking the Court to resolve a question that is in no way presented by the facts here. Most of them portray the NCUC's roll-in methodology as seeking "to change the precise allocations established by the Commission in the course of its review of the interstate arrangements" (Fed. Br. 9). Alcoa goes so far as to frame the question presented as whether a retail rate commission can "reject the interstate wholesale cost and power allocations that FERC . . . in this case actually approved" (Br. i). Alcoa and its allies have fundamentally mischaracterized Opinion No. 139.

Under the Federal Power Act, the FERC has exclusive jurisdiction over "the sale of electric energy at wholesale in interstate commerce" (16 U.S.C. §824(b)(1)); a wholesale transaction is "a sale of electric energy to any person for resale" (16 U.S.C. §824(d)). One type of wholesale electric rate schedule is a bulk power exchange arrangement among utilities in which each utility both buys and sells electricity. The NFA and 1971 Apportionment Agreement are agreements of this kind. In setting the retail rates of a utility that incurs costs under such an agreement, a state commission cannot modify, and must give effect to, the "filed rate" approved or modified by the FERC. However, in evaluating the justness and reasonableness of this type of transaction, the FERC normally does not review the question of a buyer's prudence in entering the transaction, or the reasonableness of obtaining the power in question as opposed to power from any

other source. It leaves those questions to the state ratemaking authorities when the utility attempts to pass the costs through to its retail customers, and defers such questions on the wholesale side until the utility attempts to pass the costs through to wholesale customers.

A sale for resale to full or partial requirements customers is very different from bulk power exchange transactions. The FERC's role in evaluating a utility's wholesale rates is largely analogous to a state commission's role in setting retail rates. Ratemaking determinations of one commission generally do not bind the other in this context. For example, there is no argument that the NCUC was required to follow the FERC by disallowing Nantahala's automatic adjustment clause for purchased power.

In Opinion No. 139, the FERC reviewed the bulk power arrangements in the course of determining whether roll-in was appropriate for setting rates to Nantahala's wholesale customers, *not* in its role as regulator of bulk power exchanges and allocator of costs between states. It explicitly found the arrangements to be unfair to Nantahala, but refused to modify the contractual allocation of power between Nantahala and Tapoco. Instead, FERC ordered Nantahala to assume additional entitlements for purposes of setting wholesale rates. These wholesale ratemaking determinations are not the kind of determinations that bind states in their retail ratemaking. Indeed, in acknowledging the NCUC's earlier roll-in determination, Opinion No. 139-A made clear that the FERC had no intention of binding the NCUC to its ratemaking methodology.

In order to make Opinion No. 139 fit their preemption mold, Alcoa and the supporting amici are forced to choose (or alternate between) one of three tactics. Some (most clearly, the Federal Amici) simply misstate the holdings of Opinion No. 139. Others develop a novel "imputed filed rate" doctrine, arguing that the FERC allocated costs between utilities and states even though it said it was not doing so. One amicus (NEES) acknowledges the actual nature of Opinion No. 139, but argues that because the FERC did not modify the agreements, the NCUC was bound by the letter of the agreements

even though the FERC itself departed from them in setting Nantahala's wholesale rates. Unless Opinion No. 139 is completely re-written now, the North Carolina decisions can be preempted only by altering radically the filed rate doctrine and the balance of federal and state ratemaking authority, declaring Opinion No. 139 and numerous other FERC decisions in violation of the Federal Power Act, and committing a grievous injustice with regard to 93% of Nantahala's customers.

The Commerce Clause argument of Alcoa and its allies is based on the erroneous premise that the NCUC allocated costs to Tapoco and to Tapoco's Tennessee customer, Alcoa. To the contrary, North Carolina explicitly held that Alcoa, as Nantahala's dominating stockholder and a North Carolina public utility, was responsible for the adverse results of its manipulation of its North Carolina public utility subsidiaries. That Alcoa may choose to allocate the retail refunds to its smelter for internal accounting purposes, and that the smelter happens to be located in Tennessee rather than North Carolina, does not implicate the Commerce Clause. The situation here is no different from instances where ratemaking authorities have disallowed a utility's costs, for example, those associated with a coal or construction contract, on grounds of prudence. The NCUC's orders should be upheld as even-handed regulation having only an incidental effect on interstate commerce.

ARGUMENT

I. THE NCUC'S ORDERS DO NOT VIOLATE THE SUPREMACY CLAUSE

A. FERC Opinion No. 139 Does Not Preempt The NCUC's Treatment of Federally-Filed Rate Schedules

What is most revealing about the preemption arguments of Alcoa and its allies is their inconsistency regarding what allocation of TVA entitlements they believe the NCUC was required to use in setting retail rates. NEES argues (Br. 12, 18)

that the NCUC is required to use the FERC-filed rate — the 1971 Apportionment Agreement — in setting retail rates. Apparently now recognizing that it would be absurd to require the NCUC to adhere to a contract the FERC has found unfair and from which the FERC has protected wholesale ratepayers, Alcoa and its other allies largely adopt a novel reading of the filed rate doctrine, or attempt to completely rewrite Opinion No. 139, in order to argue that the NCUC was bound to apply to retail ratemaking the same entitlements that the FERC required Nantahala to impute for setting rates to wholesale ratepayers. Alcoa now argues that even though Opinion No. 139 did not modify the 1971 Apportionment Agreement, the imputed entitlements "necessarily established the new 'filed rate' that itself became binding on the North Carolina courts and authorities" (Alcoa Br. 24; *see also id.* at 25 n.35). Federal Amici (Br. 13) attempt to radically alter Opinion No. 139 by asserting that the NCUC "ignored the Commission's filed rate as established in the wholesale rate proceeding."[7] *See also* Tenn. Br. 2-3, 10. Alcoa at times argues that the NCUC must include all costs incurred under "FERC rate schedules and decisions" (Br. 18, 20), as if the two were the same. EEI also wavers between the two. *Compare* EEI Br. 18-20 *with id.* at 20-21. The problem is that the filed rate is *not* the same as the entitlements FERC imputed in setting rates to Nantahala's wholesale customers.

These inconsistencies demonstrate that the preemption arguments proceed from a fundamental mischaracterization

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[7] *Post hoc* rationalizations offered by agency counsel in defending an agency decision on judicial review are routinely rejected by the courts. *See SEC* v. *Chenery Corp.*, 318 U.S. 80 (1943). The Federal Amici brief is entitled to even less weight, insofar as it attempts to rewrite a *prior* decision in order to preempt state decisions under review. Federal Amici's effort to drastically alter Opinion No. 139, after it has been affirmed by the Fourth Circuit and when no further review is available, is particularly egregious. If the FERC had decided Opinion No. 139 the way Federal Amici now claim, the case before the Fourth Circuit would have been significantly different.

Alcoa relies on misrepresentations offered in the Federal Amici brief, rather than on FERC Opinion No. 139. *See, e.g.*, Alcoa Br. 3 & n.2, 25 n.35.

of Opinion No. 139, as recognized by the North Carolina Supreme Court (App. 91a-98a). This is *not* a case where FERC made "cost and power allocations to North Carolina and Tennessee" (Alcoa Br. 33).[8] In Opinion No. 139, FERC left unchanged the division of TVA entitlements between Nantahala and Tapoco contained in the 1971 contract — the filed rate — but *departed* from those allocations to achieve just and reasonable rates to Nantahala's wholesale customers.[9] Rather than reviewing the inter-utility transactions as regulator of bulk power transactions, FERC in Opinion No. 139 viewed them in its role as regulator of Nantahala's rates to its three wholesale customers, a role parallel to the NCUC's role in setting Nantahala's retail rates.[10] The FERC emphasized that it was acting only in the context of establishing just and reasonable rates for wholesale customers and was not purporting to allocate interstate power flows or costs, stating that "we have not modified Nantahala's contracts [under Section 206]. Instead, we have set just and reasonable rates under our powers under Section 205." Opinion No. 139-A, App. 312a. *See also id.* at 310a-311a.[11]

[8] *See also* the erroneous proclamations of the Federal Amici that "[t]he Commission did decide, however, that adjustments were required in the 1971 Apportionment Agreement to give a somewhat bigger share of the entitlements from TVA to Nantahala . . ." (Br. 5), and that the Commission acted "by taking away some entitlements from Tapoco-Alcoa and awarding them to Nantahala . . . " (*id.* at 20).

[9] It is EEI that is confused where it attempts to characterize this as a distinction between an interstate power transaction "found just and reasonable by the FERC and one which has been merely accepted for filing by the FERC" (Br. 3-4 n.1).

[10] Compare Federal Amici's claim (Br. 9) that the "NCUC has sought to change the precise allocations established by FERC in the course of its review of the interstate arrangements."

[11] Alcoa consistently mischaracterizes the decision as making determinations under §206 establishing "cost and power allocations to North Carolina and Tennessee." Alcoa Br. 33. *See also id.* at 7, 8, 25 n.35. EEI argues that a §205 proceeding involves the FERC's authority under §206 as well (EEI Br. 18 n.13). However, in Opinion No. 139 the FERC exercised its authority to modify Nantahala's wholesale rates, rather than to modify the 1971 Apportionment Agreement.

There is no basis for adopting Alcoa's "imputed filed rate" argument and concluding that, notwithstanding contrary holdings in Opinion No. 139, the FERC intended to require the NCUC to use for retail ratemaking the same assumed entitlements that it used for wholesale rates. States in setting rates to retail customers and the FERC in setting rates to wholesale customers may use different ratemaking methodologies. *Public Systems* v. *FERC*, 709 F.2d 73, 84 (D.C. Cir. 1983). Opinion No. 139 illustrates the wide yet accepted divergence between the ratemaking policies of these two jurisdictions.[12]

Federal Amici argue that while "minor inconsistencies" between federal ratemaking applicable to a utility's wholesale customers and state ratemaking applicable to its retail customers are tolerated, this case involves allocation of "the costs of the bulk power transactions on which the company relies to obtain the power it sells to its customers . . ." (Br. 18 n.12).[13] *See also* EEI Br. 21-22. The first flaw in this argument is the view that other discrepancies between state and federal regulation are mere minor annoyances. If it were the NCUC, rather than the FERC, which disallowed Nantahala's purchased power adjustment clause ("PPAC") as inconsistent with applicable state regulations, the revenues disallowed would be very substantial.[14]

[12] The FERC rejected an NCUC-accepted treatment of amortization of Nantahala's major generating facilities (19 F.E.R.C. at pp. 61,286-87; 20 F.E.R.C. at pp. 61,872-74), and an NCUC-accepted purchased power adjustment clause (19 F.E.R.C. at pp. 61,283-85; 20 F.E.R.C. at pp. 61,871-72; 21 F.E.R.C. at p. 61,500). Their methods for determining rate base and rate of return differ significantly. *Compare* 19 F.E.R.C. at pp. 61,285-86 *with* the NCUC order, App. 222a-226a.

[13] Federal Amici proceed (Br. 18 n.12) to mischaracterize the NCUC's action as allocating costs to *customers* of a separate entity. As discussed at page 24, *infra*, North Carolina has allocated the costs not prudently incurred for the benefit of retail ratepayers to Nantahala and its stockholder, Alcoa.

[14] Or perhaps Federal Amici and EEI are suggesting that because rejection of a PPAC effectively results in refusal to pass through FERC-regulated wholesale costs, the NCUC would be preempted from enforcing its hypothetical automatic adjustment clause regulations in the way the FERC did in Opinion No. 139.

Second, and more fundamentally, the professed intolerance of Federal Amici (and EEI) of inconsistencies between state and federal treatment of bulk power transactions is inconsistent with the FERC's own regulation of such transactions. The Federal Amici have failed to inform the Court that the FERC has interpreted its responsibility under the Federal Power Act to determine the "justness and reasonableness" of bulk power transactions *not* to require inquiry into whether the transactions were prudently entered into. The FERC explicitly leaves the prudence determination to itself in setting wholesale rates, *and* to the state in setting retail rates. As explained in *Pennsylvania Power & Light Co.*, 23 F.E.R.C. ¶ 61,325 at p. 61,716 (1983) (footnote omitted):[15]

> The legislative purpose of the Federal Power Act is to ensure that the rates and terms of service for transmission and sales of electric energy subject to the jurisdiction of the Commission are just and reasonable. We have made that public interest determination here by finding that PP&L's rates under the agreement are not excessive.

[15] *Accord, AEP Generating Co.*, 29 F.E.R.C. ¶ 61,246 at p. 61,501 (1984), *motion for clarification denied*, 32 F.E.R.C. ¶ 61,364 (1985), *reh'g granted for further consideration*, November 12, 1985; *Pacific Power & Light Co.*, 27 F.E.R.C. ¶ 61,080 (1984); *Southern Company Services, Inc.*, 26 F.E.R.C. ¶ 61,360 at p. 61,795 (1984); *Southern Company Services, Inc.*, 20 F.E.R.C. ¶ 61,332 at p. 61,694 (1982); *Philadelphia Electric Co.*, 15 F.E.R.C. ¶ 61,264 at p. 61,601 (1981).

In *American Electric Power Service Corp.*, 32 F.E.R.C. ¶ 61,363 (1985) (rehearing pending), the FERC held that its determination of the justness and reasonableness of a transmission agreement that was integral to the operations of a multistate registered holding company power pool, fully subject to FERC and Securities and Exchange Commission jurisdiction, *would* preempt the states from considering the prudence of the transmission agreement. The FERC found that, in those circumstances, resolution of the transmission agreement controversies would leave nothing for the states to decide. 32 F.E.R.C. at pp. 61,817-19. Therefore, *American Electric Power Service* is not like Opinion No. 139.

> . . . We do not view our responsibilities under the Federal Power Act as including a determination that the purchaser has purchased wisely or has made the best deal available. However, these are legitimate concerns of the State commissions and this Commission as well in determining the purchaser's rates for sales to others.

Opinion No. 139 is fully consistent with this line of cases. Although the FERC left unchanged the filed agreements, it reduced Nantahala's rates to its wholesale customers to prevent the pass-through of certain costs associated with those agreements, characterizing the case as "involv[ing] the prudence of the costs incurred by Nantahala." Opinion No. 139-A, App. 312a.

Moreover, in accord with its approach concerning other prudence-related determinations, the FERC was not concerned that North Carolina might adopt a different technique to ensure that the costs passed on to retail ratepayers were prudently incurred for their benefit. Opinion No. 139-A expressly acknowledged that North Carolina applying state criteria could validly require roll-in (App. 305a):[16]

> We recognize that the North Carolina Utilities Commission (NCUC), based on a similar record, reached a different conclusion concerning rolled-in costing. However, the question of whether to treat various entities as an integrated system for ratemaking purposes is not a purely factual question, but also rests on criteria which each ratemaking authority may deem relevant.

Federal Amici improperly attempt, in a brief filed long after Opinion No. 139 was affirmed by the Fourth Circuit, to reverse this finding in FERC's decision by terming it "a casual remark of the Commission . . . that may have failed adequately to

[16] Contrast Federal Amici's assertions that the NCUC was the wrong forum for the disputes it addressed, because "the broader perspective of the federal authority" was required (Fed. Br. 11; *see also id.* at 9, 21).

distinguish the separate considerations involved in these two types of situations [allocations of costs within a single company as compared with the costs of bulk power transactions]." Fed. Br. 19 n.12. This belated effort to rewrite Opinion No. 139 not only is entitled to no weight, but is contrary to FERC's consistent interpretation of its statutory responsibilities in determining the justness and reasonableness of bulk power transactions. *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969), incorrectly cited by Alcoa (Br. 29) to demonstrate that the FERC's "reinterpretation" of Opinion No. 139 is entitled to deference, actually applies to an agency's longstanding interpretation of its statute in its *orders*. The FERC's interpretation of its statutory role in Opinion No. 139 and the *Pennsylvania Power & Light Co.* line of cases is entitled to deference. Federal Amici's new attempt to preempt state regulation merely by invoking "the Commission's exclusive jurisdiction over . . . bulk power transactions" (Br. 19 n.12) is not.[17]

EEI's "imputed filed rate" argument that in determining Nantahala wholesale rates the FERC necessarily determined "a just and reasonable allocation of entitlements and costs" (Br. 19) is without merit. To require the NCUC to adhere to the precise entitlements that the FERC attributed to Nantahala would be to single out one of the package of adjustments ordered by the FERC to achieve what it found to be just and reasonable wholesale rates under the Federal Power Act. For example, the FERC disallowed Nantahala's PPAC, which

[17]Even less convincing is EEI's claim (Br. 23) that "the FERC typically does not use rate orders to instruct state commissions on the preemption doctrine." While EEI (unlike some of its allies) correctly recognizes the wholesale ratemaking context of Opinion No. 139 and while its argument might make some sense if FERC had been silent with regard to the NCUC's roll-in order, it makes no sense where the FERC *did* speak clearly on the preemption issue, in a manner fully consistent with its precedent, in answer to arguments made by the North Carolina Attorney General, among others. Moreover, as shown in *American Electric Power Service Co.*, where the FERC concludes that the *Pennsylvania Power & Light Co.* principle should not be applied because of special circumstances, it says so. Thus, the FERC cases adequately address Alcoa's

prevented Nantahala from recovering all of the TVA power costs remaining after taking account of the additional, imputed entitlements.[18] Would the NCUC also be required to reject Nantahala's retail PPAC, which was otherwise acceptable under North Carolina standards? The FERC's imputed entitlements no more bind the NCUC than the FERC's choice of rate of return.

Even less tenable is the argument that the filed rate doctrine precludes the NCUC from allocating costs to the public on a basis other than the literal terms of the 1971 Apportionment Agreement. NEES in effect claims that while the FERC can decline to follow the filed rate so as to make wholesale rates just and reasonable under the Federal Power Act, North Carolina cannot treat the same agreements in the same manner to achieve what it concludes are just and reasonable retail rates. The FERC did *nothing* to protect Nantahala's retail customers; Opinion No. 139 explicitly left that to the State. A ruling now, after Opinion No. 139 has been affirmed by the Fourth Circuit, that the decision did not do what it said it did would leave retail ratepayers completely unprotected from what both Federal and North Carolina authorities found to be unreasonable costs.[19]

In setting rates to wholesale customers, the FERC is as bound by the filed rate doctrine as is a state commission. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 578 (1981); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956). Because that doctrine did not prevent FERC from setting wholesale rates on a basis other than the entitlements agreed to by the affiliated companies, it does not preclude the NCUC from allocating the Nantahala/Tapoco total system costs on another basis as well.

alleged concern that states might make prudence determinations that subvert the national interest (Alcoa Br. 29 n.41).

[18]Federal Amici's assertion (Br. 5) that the "[r]ates to Nantahala's wholesale customers thus reflect the respective costs of its entitlements and its purchased power" is not true.

[19]NEES' argument (Br. 18) that the NCUC's exclusive remedy is with the FERC therefore rings hollow. *See also* Alcoa Br. 19, 22, Fed. Br. 11.

Indeed, *Pennsylvania Power & Light Co.* and its progeny explicitly contemplate departure from the filed rate when the FERC and the states independently review the transaction for prudence. For example, in *Pacific Power & Light Co.*, 27 F.E.R.C. ¶ 61,080 (1984), the FERC refused to consider the feasibility or prudence of a proposed arrangement in reviewing its justness and reasonableness. Even though the filed rate therefore will remain unchanged, the FERC found that "[t]he proper forum for [wholesale customers' prudence] concerns is a [wholesale] rate case. . . ." 27 F.E.R.C. at p. 61, 148. Under NEES' interpretation of the Federal Power Act, there would be no forum for considering retail customers' prudence concerns. The small percentage of a utility's ratepayers that purchase at wholesale cannot possibly be the only consumers lawfully entitled to the protection of a prudence review of the utility's actions.

Thus, Opinion No. 139 did not bind the NCUC to rigid application either of the filed rate that the FERC itself found unfair, or of the imputed entitlements approach that the FERC adopted to set rates for Nantahala's wholesale customers only.

B. The NCUC and North Carolina Supreme Court Decisions Thus Are Entirely Consistent with This Court's Decisions and With the *Narragansett* Doctrine

The North Carolina decisions under review affect only Nantahala's *retail* rates. In no way do they interfere, directly or indirectly, with the FERC's regulation of Nantahala's *wholesale* rates. Thus, the decisions of this Court that address state interference with federal wholesale ratemaking are inapposite. *Maryland* v. *Louisiana*, 451 U.S. 725 (1981), which Alcoa asserts "is dispositive" (Br. 23), struck down a State tax on natural gas transmitted by interstate pipelines into the State from offshore wells in the federally-owned Outer Continental Shelf, primarily for sale in other states. The State's requirement that the tax be borne by the pipelines or their customers hindered the FERC's authority under the Natural Gas Act to regulate the rates at which the pipelines sold the gas for resale, and in fact was inconsistent with the FERC's ratemaking methodology. 451 U.S. at 748-50. In *Northern Natural Gas Co.* v. *State Corporation Comm'n of Kansas*, 372 U.S. 84 (1963), the State interfered with federal regulation of the wholesale sales of interstate pipelines under the Natural Gas Act by ordering interstate pipelines to rateably purchase gas from wells within the State.[20]

Preemption of state regulation of *retail* electric rates is a different matter entirely. The Federal Power Act expressly reserved for the states the regulation of retail rates and services. 16 U.S.C. §§ 824(a) and (b)(1). A state's regulation of retail transactions is limited by the filed rate doctrine. Thus, numerous cases have articulated the "*Narragansett* doctrine,"[21] which holds that state regulation must give effect to a retail utility's purchased power costs incurred under a FERC-regulated wholesale rate, whether the FERC decision has issued or is pending, and cannot interfere with or defy an actual or potential FERC interstate allocation of power costs.

However, Opinion No. 139 did *not* allocate power costs between Nantahala's ratepayers in North Carolina and Tapoco's ratepayer (Alcoa) in Tennessee.[22] Nor did it set just and reasonable purchased power expenses for Nantahala which must be allowed by the NCUC.[23] Because the FERC has acted and,

[20] *Transcontinental Gas Pipe Line Corp.* v. *State Oil and Gas Board*, 54 U.S.L.W. 4114 (U.S. Jan. 22, 1986), reaffirmed *Northern Natural Gas* under similar facts, and held that the Natural Gas Policy Act of 1978 did not delegate to the states the authority to order such transactions.

[21] *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978).

[22] This distinguishes the instant case from *Northern States Power Co.* v. *Minnesota Public Utilities Comm'n*, 344 N.W. 2d 374 (Minn.), *cert. denied*, 104 S. Ct. 3546 (1984); *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981); *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, 593 F. Supp. 363 (E.D. Ark. 1984), *aff'd on other grounds*, 772 F.2d 404 (8th Cir. 1985), *cert. denied*, 54 U.S.L.W. 3498 (U.S. Jan. 28, 1986).

[23] This distinguishes the instant case from *Narragansett Electric Co.* v. *Burke, supra*, and from *Eastern Edison Co.* v. *Dept. of Public Utilities*,

in acting, declined to preempt North Carolina's regulation of Nantahala's retail rates, the *Narragansett* cases, which struck down state decisions inconsistent with actual or potential FERC decisions, are inapposite.

In *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985), the court reversed the retail commission for accepting without scrutiny a utility's power purchases from its parent, which included the costs of cancelled nuclear plants. The court held that although the state commission could not inquire into the reasonableness of the FERC-determined wholesale rate, "the PUC may always inquire into the reasonableness of a utility's purchasing power under a FERC-approved rate given other purchase options available to the utility." 498 A.2d at 699. After discussing the *Pennsylvania Power & Light Co* line of cases, the court expressed the preemption doctrine as precluding

> examin[ation of] those matters *actually determined*, whether expressly or impliedly, by the FERC. As to those matters not resolved by the FERC, State regulation is *not preempted provided that* State regulation would not contradict or undermine FERC determinations and federal interests, or impose inconsistent obligations on the utility companies involved.

Id. at 704 (emphasis in original). The court concluded that the pertinent FERC orders did not preempt the state commission from determining the "reasonableness or prudency" of the utility's purchases. *Id.* at 704-05. *See also Pike County Light and Power Co.* v. *Pennsylvania Public Utility Comm'n*, 77

388 Mass. 292, 446 N.E.2d 684 (1983); *Public Service Co. of Colorado* v. *Public Utilities Comm'n*, 644 P.2d 933 (Colo. 1983); *Washington Gas Light Co.* v. *Public Service Comm'n*, 452 A.2d 375, 384-86 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983); *Office of Public Counsellor* v. *Indiana & Michigan Electric Co.*, 416 N.E. 2d 161, 164-65 (Ind. App. 1981); *United Gas Corp.* v. *Mississippi Public Service Comm'n*, 240 Miss. 405, 127 So.2d 404, 418-21 (1961); *City of Chicago* v. *Illinois Commerce Comm'n*, 13 Ill.2d 607, 150 N.E. 2d 776, 780-81 (1958); *Citizen Gas Users Ass'n* v. *Public Utilities Comm'n*, 165 Ohio St. 536, 138 N.E.2d 383 (1956).

Pa. Commw. 268, 465 A.2d 735, 737-38 (Pa. Commw. Ct. 1983).[24] No case in the *Narragansett* line has reversed a state commission for disallowing purchased power costs incurred under a FERC-filed rate schedule, on grounds of prudence or need for the power in question, when the FERC had left such an inquiry open to the state.[25]

The instant case illustrates the principle underlying *Sinclair*. Opinion No. 139 did not modify the 1971 Apportionment Agreement, but disallowed certain costs associated with that contract as not prudently incurred by Nantahala, and thus as not properly borne by Nantahala's *wholesale* customers; therefore, those costs were borne by Alcoa, as Nantahala's sole shareholder. *See* Opinion No. 139-A, App. 308a-309a, 312a. The NCUC determined that Nantahala was not even capable of prudent action on behalf of its ratepayers. It found Nantahala not to be an independent utility under North Carolina law, because it was developed as part of a single system by Alcoa and completely subjected to Alcoa's domination. Thus, it imposed Nantahala's refund obligation on Alcoa. *See* the NCUC's order, App. 233a. EEI's argument that the cases leaving questions of prudence and need for power to the states are not applicable to the NCUC's decision "because the prudence of Nantahala's power supply arrangements . . . is not questioned" (EEI Br. 14 n.10) is meritless.

[24] *Accord, Spence* v. *Smyth*, 686 P.2d 597, 600 (Wy. 1984).

[25] Alcoa points out (Br. 27) that *Northern States Power Co.* v. *Hagen*, *supra*, 314 N.W.2d at 38, held that the questions of "reasonableness and prudence" addressed by the state commission must be litigated at the FERC. In that case, the state commission had disallowed abandoned nuclear plant costs that the FERC had expressly allocated between affiliated utilities operating in different states, in the context of approving as just and reasonable an amended coordination agreement that allocated those costs. *Northern States Power Co.* v. *Hagen*, *supra*, 314 N.W.2d at 34. *See also Northern States Power Co.* v. *Minnesota Public Utilities Comm'n*, *supra*, 344 N.W.2d at 375-76.

Federal Amici blur the distinction between cases in which the FERC has allocated costs between utilities and between states, and a FERC wholesale rate case, by misleadingly characterizing the *Northern States Power Co.* cases as involving a utility's "rate design" as distinct from its "revenue requirement" (Fed. Br. 16-17). Actual FERC "rate

Federal Amici and Alcoa attempt to avoid *Sinclair* and *Pike County* by ignoring the line of FERC cases on which *Sinclair* relies, and by insisting that Opinion No. 139 left nothing for North Carolina to decide (Fed. Br. 19-20; Alcoa Br. 28 n.41).[26] Alcoa argues that this Court should hold that "a State may not disallow [purchase power] costs . . . unless a filing has been made with FERC *and* FERC has made it explicit that it has not found the local utility's contractual arrangement to be prudent and in the overall public interest" (Br. 29 n.41, emphasis in original). Whatever the general merits of Alcoa's suggestion, this is exactly what happened in Opinion No. 139.

NEES' argument that Nantahala's power supply can be conceptualized as a "rate" paid to Nantahala for its sale of its hydroelectric output to TVA,[27] and that "[n]o one has argued that FERC lacks jurisdiction to investigate the prudence of a seller's rates under the Federal Power Act," is pure sophistry (NEES Br. 15 n.9; *see also id.* at 6). Here, the FERC determined not to address matters concerned with the reasonableness of Nantahala's power supply for its retail customers; those matters were addressed by the NCUC.

NEES also argues that *Pike County* and *Sinclair* were wrongly decided because the FERC *must* determine all questions related to the reasonableness and prudence of a utility's bulk power supply (Br. 15 n.9). *See also* EEI Br. 18-20. This radical attempt to preempt state retail regulation flies in the face of the FERC's interpretation of the Federal Power Act, and would, if adopted, render a number of FERC decisions, including Opinion No. 139, in violation of the Federal Power

design" determinations, made in a wholesale rate case, do not bind state retail commissions. For instance, the FERC and the NCUC reached different conclusions on Nantahala's PPAC, a true rate design issue.

[26] The Federal Amici also attempt to supplement Opinion No. 139 with conclusions about Nantahala's power supply that are not in the decision itself (Fed. Br. 20).

[27] Contrast Opinion No. 139-A's examination of the "discrepancy in the rates paid by Nantahala and Tapoco" to TVA (App. 307a).

Act.[28] In this case, the result of NEES' argument is absurd as well as unjust: imposition on retail customers of costs that the FERC found unfair and refused to impose upon wholesale customers. Moreover, this result would be inconsistent with the thrust of *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Comm'n*, 461 U.S. 375 (1983), where the Court held that the states are not preempted from regulating the wholesale sales of rural electric cooperatives, when the FERC had determined that it did not have jurisdiction over such sales. The Court declared that "Congress' purpose in [enacting the Federal Power Act in] 1935 was to fill a regulatory gap, not to perpetuate one." 461 U.S. at 384. The Court also concluded that the FERC had not determined that the transactions at issue should be unregulated. *Id.* at 384-85.

The arguments that the NCUC was preempted from using roll-in to pierce the corporate veil have no support. The NCUC did not use roll-in to defeat or disallow any FERC allocation of costs to North Carolina or Nantahala; there was no such FERC allocation.[29] The FERC's rejection of roll-in for setting Nantahala's wholesale rates did not have the purpose or effect of allocating costs between utilities or states. Thus, the cases on which EEI and Alcoa rely (EEI Br. 13-15 & n.11; Alcoa Br. 33 n.46) are inapplicable here.[30]

[28] Federal Amici, understandably, do not take this self-defeating position; rather, they mischaracterize Opinion No. 139 and ignore the FERC decisions that it resembles.

[29] In a puzzling discussion of *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581 (1945), NEES appears to argue that the NCUC attempted to use roll-in to eliminate Nantahala and Tapoco, and thus to eliminate the 1971 Apportionment Agreement as a wholesale arrangement under FERC's jurisdiction (*see* NEES Br. 7-8). Alcoa appears to make a similarly absurd suggestion (*see* Br. 11 and n.16).

[30] *Sinclair Machine Products, supra*, 498 A.2d at 706, held that the state commission could not use a piercing of the corporate veil rationale to disallow flow-through of abandoned nuclear plant costs that the FERC had determined should be flowed from one utility to its retail subsidiary. *Office of Public Counsellor* v. *Indiana and Michigan Electric Co., supra*, 416 N.E. 2d at 164-65, held that where the FERC regulated sales to a utility by its nuclear generation subsidiary, a state could not use roll-in to reduce the FERC-determined rate of return received by

C. Preemption of the North Carolina Decisions Now Would Result in Confusion and Injustice

The picture that Alcoa and various amici paint of the FERC as the sole regulator of all retail rate effects of bulk power agreements is wrong. In accord with the FERC's normal practice, Opinion No. 139 did not preempt the NCUC from inquiring into the prudence of Nantahala's power supply arrangements. Because this was not a case in which the FERC concluded that it must decide interstate, inter-utility cost allocations in light of interstate controversies, a preemption ruling here would require this Court to hold that Opinion No. 139 itself, and numerous other FERC decisions that have reserved questions of prudence and need for power for retail and wholesale rate cases, are in violation of the Federal Power Act. Such a result would leave Nantahala's retail customers with no relief at all. In addition, in numerous other cases not before this Court, the FERC has left retail ratepayers with no forum to resolve questions of prudence and reasonableness of power supply options except state commissions.

This case is but a stage in a longstanding and unique controversy between the Alcoa family and the public served by Nantahala. The broad policy considerations advanced in support of preemption are inapplicable here. Alcoa and others argue that the system of federal-state electric regulation resulting from the Federal Power Act is endangered when a state disregards or relitigates determinations made by the FERC, or when retail electric regulation in two or more states clashes, or imposes inconsistent obligations on an interstate system or utility. The decisions under review do not conflict with binding FERC determinations in Opinion No. 139. To be sure, the NCUC and the FERC, after their prudence-related investigations, reached different decisions as to the amount of costs that should be allocated from ratepayers to Nantahala's shareholder, Alcoa. However, this result is no more barred by the Federal Power Act and the Supremacy Clause than are differing conclusions of regulatory commissions as to the prudence of a utility's coal contract.

the subsidiary. More generally, a state cannot disregard or disallow costs incurred under FERC-jurisdictional rate schedules *merely* because the wholesale transactions involve affiliates. *See, e.g., United Gas Corp.* v. *Mississippi Public Service Comm'n, supra*, 127 So. 2d at 420.

Also irrelevant are the speculations as to the consequences if Tennessee were to regulate Tapoco's rates, or if Tapoco were to serve others besides Alcoa in Tennessee (Alcoa Br. 30; Tenn. Br. 11; EEI Br. 12-13 and n.9, 23). The Tennessee Public Service Commission has never regulated and does not regulate Tapoco's rates to Alcoa. With regard to Tapoco/Alcoa, Tennessee's concern is with jobs, not with electric regulation within its borders.[31] Neither Tennessee nor anyone else has explained how or why Tennessee would regulate Tapoco's rates.

In light of Opinion No. 139, the FERC's interpretation of its statutory mandate, and the unique facts of this case, the North Carolina decisions should stand.

II. THE NCUC'S ORDERS DO NOT VIOLATE THE COMMERCE CLAUSE

The Commerce Clause arguments of Alcoa and its allies arise from the premise that the NCUC reallocated costs from the North Carolina public load to Tennessee or to "Tapoco's Tennessee customers" to give North Carolina a preference to the low cost hydroelectric power. *See, e.g.*, Alcoa Br. 11-15. This completely misconstrues the nature of the NCUC's orders

[31] Tapoco's sales to Alcoa are regulated by the FERC as a rate schedule of a hydroelectric licensee under Part I of the Federal Power Act (16 U.S.C. §§812 and 813; *see also* 18 C.F.R. §35.21 (1985)), and were not at issue in, or affected by, the FERC orders pertinent here (App. 309a). The 1955 Tennessee Commission order to which Tennessee refers (Br. 11) merely asserted a right to require Tapoco to submit to its jurisdiction.

Although Tennessee asserts that it "has had no opportunity to participate in the decisions at issue" (Br. 7), it submitted an *amicus* brief to the North Carolina Supreme Court, and its arguments were considered (App. 10a, 106a). Tennessee complains that the North Carolina Court of Appeals denied its motion to file an *amicus* brief (Br. 15); that motion was submitted a month out of time.

and, in particular, the NCUC's explicit determination to hold Alcoa, *as Nantahala's dominating stockholder*, not as Tapoco's customer, responsible for manipulating its public utility subsidiaries to the detriment of the North Carolina public.

The NCUC's retail rate order neither intended nor resulted in economic protectionism or regulation of interstate commerce. The NCUC's establishment of retail rates by combining the costs of Nantahala and Tapoco, and allocating to the public its proportionate share of the joint costs — as it does for every other utility operating in more than one state (*see* the North Carolina Supreme Court's discussion, App. 16a, 101a) — rested on factual findings well within the traditional purview of a retail commission. Roll-in was based on findings, as affirmed and summarized by the North Carolina Supreme Court, that Tapoco and Nantahala are North Carolina public utilities and that

> (a) Nantahala has not been designed, developed and operated as a stand-alone electric system, (b) the Nantahala and Tapoco electric facilities constitute a single integrated electric system, and (c) the two corporate affiliates should be treated as a single utility system for rate making purposes, in view of their historical development, actual operating conditions and the fact that Nantahala's customer cost responsibility cannot be accurately determined using a "stand-alone" model. . . .

App. 136a-137a. The NCUC's decision found that Alcoa dominated Nantahala, so that Nantahala was incapable of protecting its ratepayers, and therefore pierced the corporate veil to hold Alcoa, as Nantahala's stockholder, responsible for the refunds which exceeded Nantahala's ability to pay (*id*. at 233a).[32]

[32] Federal Amici's characterization of the NCUC's action as "not . . . disallow[ing] the costs at issue here, [but] simply . . . shift[ing] them to the out-of-state customer of the other utility" (Br. 16 n.11) is the opposite of what the NCUC did, and is in no way supported by the citation they offer (to App. 86a). Their suggestion that disallowance of costs would result in confiscatory rates is not before this Court (*see* Supreme Court Rule 15.1(a)) and is inconsistent with the FERC's actions in

When the interests of a regulated company are subordinated to an affiliate so as to benefit private interests to the injury of the public the regulatory scheme was designed to protect, it may be appropriate or necessary to pierce the corporate veil to halt and redress the injury.[33] The NCUC acted appropriately under North Carolina law to protect retail ratepayers because Alcoa has not behaved as a mere investor in Nantahala, but rather has manipulated Nantahala and Tapoco to procure for itself low-cost power.[34]

State commissions plainly may act to protect ratepayers from imprudent actions of public utilities, utility acquisitions that are not used and useful for retail ratepayers, or unreasonable costs imposed by inter-affiliate manipulations. Any disallowance of costs will have an impact on the company and its stockholders. The geographical location of the stockholders and their other interests does not implicate the Commerce Clause.

Nor does the Commerce Clause prevent the NCUC from effectively regulating these North Carolina public utilities simply because Alcoa located its unregulated smelting operations across the state line from the public it exploited. Nothing in the North Carolina decisions suggests that they would have been decided differently if Alcoa's plant were in North Carolina. Because Opinion No. 139 did not preempt the NCUC's

Opinion No. 139 with respect to both the "imputed" entitlements and the disallowance of Nantahala's PPAC.

[33] *See, e.g., Colorado Interstate Gas Co.* v. *FPC, supra*, 324 U.S. at 606-08; *United Fuel Gas Co.* v. *Railroad Comm'n of Kentucky*, 278 U.S. 300, 320-21 (1929); *Chicago, Milwaukee & St. Paul Ry.* v. *Minneapolis Civic & Commerce Ass'n*, 247 U.S. 490, 500-01 (1918). *See also* the North Carolina Supreme Court's discussion, App. 113a.

[34] *See* the North Carolina Supreme Court's discussion, App. 113a-122a. *See also United States* v. *Reading Co.*, 253 U.S. 26, 48, 60-63 (1920); *Chicago, Milwaukee & St. Paul Ry.* v. *Minneapolis Civic & Commerce Ass'n, supra*, 247 U.S. at 500-01. Indeed, the North Carolina Supreme Court held that the statute that makes Alcoa a North Carolina public utility insofar as its ownership and control of Nantahala affects the latter's rates is designed to facilitate review and remedy of such abuses as were found in this case (App. 110a-112a).

roll-in and left protection of retail ratepayers to the State, Alcoa's argument amounts to no more or less than an effort to eliminate *any* forum where it can be forced to bear the consequences of its actions as they have affected 93% of Nantahala's load.[35]

Moreover, the NCUC's orders have only an incidental effect on interstate commerce. They are directed against Nantahala in the first instance, and are an unexceptional example of a state disallowing costs not incurred for the benefit of ratepayers. The NCUC went on to pierce the corporate veil, to require Alcoa to pay refunds exceeding Nantahala's ability to pay, but it expressly stated that this neither required nor contemplated any effect on Tapoco's rates to Alcoa (App. 241a, 243a). That Alcoa is both Nantahala's stockholder and Tapoco's customer, and that Alcoa's purpose in manipulating its subsidiaries has been to obtain benefits through Tapoco's sales to Alcoa's smelter, does not make refunds a cost of purchasing Tapoco power.

Thus, the NCUC's orders do not impermissibly interfere with interstate commerce under the standards set forth in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970). Where a state "regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." 397 U.S. at 142. The incidental burden on interstate commerce here cannot outweigh North Carolina's strong interest in effective utility regulation. *See, e.g., Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Comm'n*, *supra*, 461 U.S. at 377, 394-95.

In *Western Distributing Co.* v. *Public Service Comm'n*, 285 U.S. 119 (1932), a case whose facts were close to those of *Narragansett Electric Co.* v. *Burke*, *supra*, the Court held that

[35] This is not a case where FERC review provided the "same substantive protections" as NCUC review, or where the NCUC simply provided additional protections that "go beyond" those provided by the FERC, as claimed by Alcoa (Br. 39, *quoting Edgar* v. *MITE Corp.*, 457 U.S. 624, 644-45 (1982)).

the Commerce Clause did not bar a state from inquiring into the reasonableness of the costs of a local gas distribution company's purchases from its affiliate under an interstate gas rate. The Court ruled that such an inquiry was vital to effective state regulation of intrastate retail rates, and that it did not constitute an impermissible regulation of interstate commerce. 285 U.S. at 124-25. The *Western Distributing Co.* case was decided prior to the enactment of the Federal Power Act of 1935, when there was no regulation of interstate wholesale sales. In the instant case, the FERC explicitly left it open to North Carolina to protect retail customers from Nantahala's imprudence in its transactions with affiliates. Thus, *Western Distributing Co.* supports the inquiry undertaken by the NCUC here.[36]

The NCUC's actions are not at all comparable to the economic protectionism held unconstitutional in *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982) ("NEPCO"). The NCUC did not prohibit the export of North Carolina hydroelectric power, or the economic benefits of such power, so as to retain it for in-state residents. The NCUC only established Nantahala's retail rates in a manner which assures Nantahala ratepayers a fair allocation of the Nantahala/Tapoco total system costs and does not disproportionately burden them with the costs of Alcoa's manipulations. In contrast to *NEPCO*, no wholesale sales were ordered, and no changes in wholesale rates were the necessary consequence of the NCUC's orders.[37] Moreover, in *NEPCO*, the loss a utility would incur if it continued to sell hydroelectric power out-of-state served no legitimate (non-protectionist) state interest. There *is* an important state interest in requiring Alcoa, Nantahala's stockholder, to bear the costs it caused Nantahala to incur for its benefit.

[36] Federal Amici appear to agree that if the NCUC's orders are not protectionist (which they are not), they may well pass muster under *Bruce Church* (Fed. Br. 24). In essence, they are suggesting that this Court use this case to overrule its recent Commerce Clause decisions (*see id.* at 24-25). However, their suggestion that the Court return to "pre-[Federal Power] Act Commerce Clause cases" (*id.* at 25) might not have the result they seem to think.

[37] Tennessee is wrong when it asserts (Br. at 8) that the issue in *NEPCO* was a state's establishment of retail rates. *See* 455 U.S. at 335-36.

In *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, 772 F.2d 404 (8th Cir. 1985), *cert. denied*, 54 U.S.L.W. 3498 (U.S. Jan. 28, 1986), the Arkansas commission explicitly sought to defy FERC orders requiring Arkansas Power & Light Company to share with its affiliates in other states the costs of a nuclear project. The NCUC's effort to protect public ratepayers from what it found to be the detrimental effects of Alcoa's dominance thus is not comparable to the Arkansas commission's efforts to keep high-cost power out of Arkansas.

Alcoa and its allies place great emphasis on the NCUC's "first call" language in their effort to portray the NCUC's actions as economic protectionism. As explained by the North Carolina Supreme Court (App. 101a-103a), this language is neither the basis for nor the effect of the NCUC's orders.

Alcoa points to the NCUC's refusal to roll-in Alcoa's separate TVA purchases (Br. 12). However, even Alcoa characterizes these purchases as among the sources of power for "Nantahala and Tapoco/Alcoa", not for the integrated Tapoco/Nantahala system the NCUC was addressing (Br. 4 n.5). As found by the NCUC, TVA's direct sales to Alcoa are not part of Tapoco's utility operations (contrary to the impression Alcoa seeks to convey at Br. 3), and even if they were, the cost of such specialized purchases would be separately assigned to Alcoa under standard allocation methodology (*see* the North Carolina Supreme Court at App. 65a-66a, and the NCUC at App. 211a-215a).[38]

Alcoa next complains that the NCUC's allocation of the Nantahala/Tapoco costs on the basis of Nantahala's "ever-increasing" demand for power somehow constitutes a "first

[38] Alcoa claims (Br. 15 n.27) that the NCUC's refusal to roll-in Alcoa's purchases is inconsistent with its holding that Alcoa is a North Carolina public utility. The NCUC's October 3, 1980 order with regard to Alcoa's public utility status (which, although a part of the NCUC's order (App. 179a), was omitted from Alcoa's Appendix) is premised on the finding that Alcoa's affiliation with Nantahala affects rates. That finding has nothing to do with the ratemaking treatment of Alcoa's separate TVA purchases.

call" on hydroelectric power (Br. 13). There is nothing extraordinary about allocating system costs on the basis of load (*supra* at page 24.). That Nantahala's load is increasing as compared with Alcoa's partial requirements purchases from Tapoco simply means that *if* this same methodology is applied in the future, Nantahala's ratepayers gradually will bear a greater proportion of the costs of all Tapoco/Nantahala resources (which will gradually include more TVA purchases). The NCUC's refusal to allocate costs on the basis of Nantahala's contribution to TVA, determined by Alcoa through its manipulation of the hydroelectric properties and of contracts the NCUC found detrimental to Nantahala, evinces protection of ratepayers from abuse rather than economic protectionism.

Nor was it economic protectionism for the NCUC to use the Nantahala/Tapoco system capacity rather than the NFA entitlements as the basis for its allocations, contrary to Alcoa's claims (Br. 13-14). The NCUC found that in the NFA, Alcoa traded away the much larger system capacity of Nantahala and Tapoco to obtain entitlements peculiarly suited to its needs and of no value to Nantahala's public load (*see* the North Carolina Supreme Court's discussion at App. 67a-68a, 102a-103a).[39] The NCUC's determination not to charge ratepayers for this Alcoa trade does not constitute economic protectionism.

The NCUC's orders serve legitimate and substantial local interests with only incidental and not excessive effects on interstate commerce. They in no way violate the Commerce Clause.

[39] Alcoa mischaracterizes this trade as mere "banker's" services provided by TVA (Br. 5 n.7).

CONCLUSION

The judgment of the Supreme Court of North Carolina should be affirmed.

Respectfully submitted,

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February 22, 1986